UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

THE BENNETT FUNDING GROUP, INC. — CASE NO. 96-61376
Chapter 11
Debtors — Substantively Consolidated

RICHARD C. BREEDEN, as trustee for
THE BENNETT FUNDING GROUP, INC., et al.

Plaintiff

vs. — ADV. PRO. NO. 98-41254A

NELSON FERNANDES

Defendant

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

Presently before the Court is a motion filed by Nelson Fernandes ("Defendant") on November 5, 2002, seeking an Order dismissing the adversary proceeding commenced against him on February

12, 1998, by the chapter 11 trustee, Richard C. Breeden ("Trustee" or "Plaintiff"), appointed in the above-referenced cases. Defendant seeks dismissal of the Trustee's complaint ("Complaint") based upon a lack of jurisdiction and a failure to state a claim upon which relief can be granted with respect to certain state law claims.[1] Defendant also seeks to amend his answer to include affirmative defenses of fraud and the "Wagoner rule." On December 9, 2002, the Trustee filed his response, as well as a cross-motion seeking to enjoin Defendant from filing any further motions in the adversary proceeding without first obtaining leave of the Court. On January 13, 2003, Defendant filed his unsigned reply to the Trustee's cross-motion, alleging that Trustee's counsel's representations were false and the cross-motion frivolous. The Trustee filed a supplemental response to the Defendant's motion on January 24, 2003.

The Defendant's motion was originally scheduled to be heard on November 21, 2002, in Binghamton, New York. The motion was subsequently adjourned to December 12, 2002 at the request of the Trustee but without the consent of the Defendant. It was again adjourned to January 30, 2003, on the consent of both parties. As has been the Court's practice in the past in connection with this particular adversary proceeding, the motion was carried on the Court's motion calendar without oral argument and was submitted for decision on January 30, 2003, based on the various arguments set forth in the papers filed with the Court by both parties.

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[1] The Trustee's Complaint originally contained two causes of action, the first based on § 548(a) of the Bankruptcy Code, 11 U.S.C. § 101-1330 ("Code") and the second based on Code § 544(b) and § 550, as well as § 261-277 of the New York Debtor and Creditor Law ("NYD&CL"). The Court previously dismissed the first cause of action upon motion by the Defendant. *See Breeden v. Fernandes (In re The Bennett Funding Group, Inc.),* Case No. 96-61376, Adv. Pro. No. 98-41254 (Bankr. N.D.N.Y. Feb. 22, 2002) ("February 2002 Decision")

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of this adversary proceeding pursuant to 28 U.S.C. §§ 1334(b), 157(a), (b)(1) and (b)(2)(A), (H) and (O).

BACKGROUND

Since this adversary proceeding was commenced on February 12, 1998, a review of the docket reveals that the Defendant has filed several motions seeking relief on a *pro se* basis. As early as July 13, 1998, he filed a motion to strike the Trustee's reply to Defendant's counterclaim and for default judgment. The motion was denied on August 21, 1998, and the Defendant was ordered to accept the Trustee's reply. On November 14, 2000, he filed a motion for summary judgment and dismissal of the adversary proceeding based on his contention that the Trustee had failed to make proper inquiry into the facts. That motion was later withdrawn on or about September 13, 2001. In the interim, on August 28, 2001, the Defendant filed a motion seeking dismissal of the adversary proceeding. The Court dismissed the first cause of action of the Complaint but declined to grant similar relief with respect to the second cause of action. *See* February 2002 Decision. On March 22, 2002, the Defendant filed a motion seeking reconsideration of the February 2002 Decision and also asserting for the first time that the Court lacked subject matter jurisdiction to address the matters raised in the Trustee's Complaint. The Court concluded that it had jurisdiction and denied the Defendant's motion for reconsideration.

See Breeden v. Fernandes (In re The Bennett Funding Group, Inc.), Case No. 96-61376, Adv. Pro. No. 98-41254 (Bankr. N.D.N.Y. July 8, 2002) ("July 2002 Decision"). On July 29, 2002, Defendant filed yet another motion seeking reconsideration of both the February 2002 Decision and the July 2002 Decision and also asking that the Court recuse itself. The Court denied the Defendant's motion in all respects in a Letter Decision and Order, signed September 6, 2002 ("September 2002 Decision"). As noted above, the current motion was filed by the Defendant on November 5, 2002.

For purposes of this discussion, the Court will assume a familiarity with the facts as set forth in the above-referenced three prior Decisions.

DISCUSSION

Defendant's Motion to Amend his Answer to Assert Additional Affirmative Defenses

In his Answer, filed March 13, 1998, Defendant asserted several affirmative defenses, including (1) lack of subject matter; (2) lack of personal jurisdiction; (3) improper venue; (4) insufficiency of process; (5) insufficiency of service of process; (6) failure to state a claim upon which relief can be granted; (7) failure to join the securities firms that sold Bennett Funding to the defendant, in order to establish bad faith conduct and (8) waiver. Defendant now seeks to amend his Answer to assert additional affirmative defenses, including fraud and the Trustee's lack of standing based on the "Wagoner rule."

Whether to allow the Defendant to amend his Answer is within the discretion of this Court. A motion to amend should be granted unless it would cause undue delay, is sought in bad faith, would

result in undue prejudice to the opposing party or is legally deficient and futile. *See Foman v. Davis* 371 U.S. 178, 182 (1962); *see also Monahan v. New York. City Dept. Of Corrections*, 214 F.3d 275, 283 (2d Cir.), *cert. Denied* 531 U.S. 1035 (2000) . With respect to it being legally deficient and futile, basically, a court will deny a request to amend a pleading when the amended pleading would not survive a motion to dismiss. *See Kovian v. Fulton County National Bank and Trust Co.*, 1992 WL 106814 at *1 (N.D.N.Y. 1992) (citations omitted).

Fraud is one of the affirmative defenses listed in Rule 8(c) of the Federal Rules of Civil Procedure ("Fed.R.Civ.P."), as incorporated in Rule 7008 of the Federal Rules of Bankruptcy Procedure ("Fed.R.Bankr.P."), made applicable to this proceeding. Defendant is not challenging the transactions between himself and BFG as having been fraudulent and misleading. Rather, the Defendant alleges that the Trustee's allegations in his Complaint are fraudulent and misleading because of the use of the word "pledge," rather than the word "assign" in the context of certain lease transactions involving the Bennett Funding Group, Inc. ("BFG" or "Debtor") and the Defendant. This assertion is legally insufficient as a defense to the Trustee's allegations of fraudulent conveyances. Therefore, the Court will deny the Defendant's motion insofar as it seeks to add an affirmative defense of fraud.[2]

The "Wagoner rule" is not an affirmative defense specifically identified in Fed.R.Civ.P. 8(c). The rule pertains to the standing of a trustee and addresses the question of when a trustee may assert claims against third parties on behalf of a debtor corporation's creditors as opposed to the claims of the

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[2] Defendant's arguments concerning the use of the word "pledge" instead of the word "assign" mirror those he made in his dismissal motion of August 28, 2001, which was previously denied by this Court. *See* February 2002 Decision at 6-9.

corporation itself. *See Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114 (2d Cir. 1991). Although a lack of standing has been treated by some courts as an affirmative defense, *see, e.g., LaSalle National Bank v. Owens-Illinois, Inc.*, 1994 WL 249542 at *2 (N.D.Ill. 1994); *Gaskill v. Gordon*, 1993 WL 64642 (N.D.Ill. 1993), this Court finds that it is more properly considered as a basis for dismissal of the complaint and, thus, it will be discussed below. *See In re Ackerman*, 247 B.R. 336, 339 (Bankr. M.D.Fla. 2000).

Defendant's Motion to Dismiss the Complaint

With respect to the Defendant's assertion that the Wagoner rule should apply to prevent the Trustee from seeking to avoid alleged fraudulent conveyances, the courts have concluded that the rule does not apply to a trustee who is exercising his avoidance powers:

> In exercising avoidance powers under section 544(b), a trustee acts as a representative of the creditors of the estate. Hence, a trustee's ability to obtain a recovery for an estate and its blameless creditors may not be denied by the prepetition wrongful conduct of the debtor.

In re Wedtech Corp., 88 B.R. 619, 622 (Bankr. S.D.N.Y. 1988) (citations omitted); *see also In re Leasing Consultants, Inc.*, 592 F.2d 103, 110 (2d Cir. 1979) (stating that "[w]hen acting under this section [predecessor to § 544(b)], a trustee is vested with the rights of creditors and is not limited to the rights of the bankrupt."). Accordingly, the Trustee has standing to avoid fraudulent conveyances pursuant to Code § 544(b) and the Wagoner rule has no application to the matter herein.

Defendant also argues that the Complaint should be dismissed based on a lack of subject matter jurisdiction. The Defendant previously asserted that the Court lacked subject matter jurisdiction to

address the matters raised in the Trustee's Complaint in an earlier motion for reconsideration, which was denied. *See* July 2002 Decision. It is the Defendant's position that he is not barred from presenting the Court with a different factual theory that would prove that the Court lacks jurisdiction.

As noted by this Court in its July 2002 Decision, the issue of subject matter jurisdiction over an action or proceeding can be raised at any time. *See id.* at 3, citing *Zimmerman v. United States*, 2000 WL 1280908 at * 1 (E.D. Calif. 2000). The Defendant argues that the Trustee's second cause of action, which is based on alleged fraudulent conveyances to the Defendant during the six year period prior to March 29, 1996, the date BFG and several other related corporate entities filed voluntary petitions in this Court, was pled for the sole purpose of achieving jurisdiction in this Court. *See* Defendant's Motion at 10 (stating that "it appears that the Trustee alleged a fraudulent conveyance claim in order to achieve jurisdiction in this court.") and Defendant's Reply to Trustee's Cross-Motion, filed January 13, 2003, at 8 (asserting that the Trustee's Complaint is a "fraudulent scheme intended to achieve federal jurisdiction on order to use this venue to intimidate investors . . . ."). It is Defendant's contention that the Trustee's claims "cannot sustain jurisdiction since interest is fair consideration." *Id.*

These statements appear to this Court to simply be another attempt by the Defendant to argue that the adversary proceeding should be dismissed based on an alleged failure to state a claim, rather than a lack of subject matter jurisdiction. It does not, in the opinion of this Court, constitute a basis for a finding that the Court lacks jurisdiction to address the substantive issues raised in the Trustee's complaint. The fact that the Trustee may not succeed in proving the elements necessary to avoid the transfers, as Defendant alleges, does not form a legal basis for denying him the opportunity to appear before this Court to submit such proof.

Defendant also seeks dismissal of the Trustee's Complaint for failure to state a claim upon which relief can be granted. As it has done previously, the Court interprets the Defendant's motion as one brought pursuant to Fed.R.Civ.P. 12(b)(6), made applicable to this proceeding by Fed.R.Bankr.P. 7012. The Trustee asserts that because this Court denied the Defendant's motion pursuant to Fed.R.Civ.P. 12(b)(6) in its February 2002 Decision, the Defendant is precluded from raising this defense again, citing Fed.R.Civ.P. 12(h)(2), and is also bound by the law of the case.

"The Federal Rules of Civil Procedure are specifically designed to be flexible enough to allow substantial justice to be done in any given case." *Horwitz v. Food Town, Inc.*, 241 F.Supp. 1, 2 (E.D. La. 1965), *aff'd* 367 F.2d 584 (5th Cir. 1966). In *Horwitz* the defendants filed a motion to dismiss for failure to state a claim. The motion was denied and later the defendants filed a motion for summary judgment, again arguing that the plaintiff's complaint failed to state a claim. Plaintiffs argued that the motion had previously been ruled upon and was too late. The court did not agree, indicating that it would simply consider it as a motion for reconsideration of the court's prior denial. *Id.; see also Van Voorhis v. District of Columbia*, 240 F.Supp. 822, (D.D.C. 1965). In *Van Voorhis* the defendant's motion to dismiss the complaint for failure to state a claim was denied. Following a trial before a jury, which was unable to reach a decision on the merits, the defendant reasserted the defense in his motion for judgment. Plaintiff argued that the law of the case applied and that if the question was incorrectly decided by the trial court, it could be resolved on appeal. The district court disagreed, finding that

> there is a sound reason for not applying the law of the case doctrine where the prior ruling was on a motion to dismiss under Rule 12(b)(6) . . . . The defense of failure to state a claim upon which relief can be

> granted cannot be waived and can be asserted at the trial on the merits and hence neither the defendant nor the trial court is concluded [sic] by a prior ruling on a motion to dismiss from reconsidering the questions previously raised.

Id. at 824 (citations omitted).

Having concluded that the Defendant is entitled to seek dismissal of the Complaint for failure to state a claim on which relief may be granted, the Court, nevertheless, will deny the motion. Like the portion of his motion seeking dismissal based on an alleged lack of subject matter jurisdiction, the basis for Defendant's motion is the argument that the Trustee cannot succeed on his second cause of action based on NYD&CL § 271-276 because the interest the Defendant received from BFG in connection with his investment in the leases constitute fair consideration. He also argues that to allow the Trustee to proceed with the cause of action would constitute an impermissible impairment of BFG's contractual obligation to pay interest to the Defendant. Those arguments are not appropriate in the context of a motion to dismiss the Complaint for failure to state a claim as they require factual determinations more appropriate in the context of a motion for summary judgment or in the context of a trial.

Trustee's Cross-motion for Injunctive Relief

The Trustee argues that the motions brought by the Defendant have forced the Estate to expend time and money to respond to issues already litigated and decided. It is the Trustee's position that the Defendant "has abused the system, the Court and the Estate by engaging in frivolous litigation designed solely to harass the Plaintiff." The Trustee requests that the Defendant be enjoined from filing any further motions without consent of the Court, citing to *Fernicola v. General Motors Acceptance Corp.*,

2003 WL 113460 (N.D.N.Y. 2003).

Defendant responds that the Trustee makes broad accusations that do not prove "dilatory tactics" or "bad faith" on Defendant's part that would justify sanctions pursuant to Fed.R.Civ.P. 11. In support of his position, he quotes the Court of Appeals for the Second Circuit:

> Broad findings of frivolous litigation, dilatory tactics or bad faith are insufficient to support the award of sanctions under Rule 11; specific findings should identify the particular papers signed by counsel.

Coltrade Intern., Inc. v. U.S., 973 F.2d 128, 131 (2d Cir. 1992) (citations omitted).

The Court has reviewed the Trustee's cross-motion seeking injunctive relief. Nowhere is there reference made to Fed.R.Civ.P. 11 or a request for monetary sanctions. The Court is mindful that *pro se* litigants are generally afforded a wide degree of latitude and their pleadings are to be interpreted liberally. *See McPherson v. Coombe*, 174 F3d. 276, 280 (2d Cir. 1999). Having said that, the Court certainly understands the Trustee's frustrations in having to respond to motions filed by the Defendant which, in most instances, have been found to be without merit. The Court feels they would not have been brought but for Defendant's unfamiliarity with the law, particularly Title 11 of the United States Code ("Bankruptcy Code"). The Court too has struggled with interpreting his arguments so as not to deny the Defendant his day in court.

In *Fernicola* at least one court had found it necessary to issue an injunction against the plaintiffs in order to prevent them from "'continuing their campaign of harassment through the legal system.'" *Fernicola*, 2003 WL 113460 at *1, quoting *Fernicola v. Specific Real Property in Possession*, No. 00 CIV 5173 (MBM), 2001 WL 1658257 at *9 (S.D.N.Y. Dec. 26, 2001). The United States District Court for the Northern District of New York found that the plaintiffs had "filed multiple lawsuits

and proceedings in this and other courts based upon or related to the alleged trust which have absolutely no basis in fact. *Fernicola*, 2003 WL 113460 at *3. The court concluded that "[a] filing injunction is necessary to prevent the Fernicolas' further abuse of the legal system." *Id.*

The actions of the Defendant in filing his various motions certainly do not rise to the level of abuse as outlined in the *Fernicola* case. However, it is also quite apparent that his repeated motions are basically an effort to seek "a second bite of the apple" without there being a sound basis in law for the relief being sought. Furthermore, had they been filed by an attorney, there is a strong possibility that they would warrant "Rule 11" sanctions.

Accordingly, the Court will deny the Trustee's motion for an injunction. However, the Court deems it appropriate to provide the Defendant with notice that any further motions for dismissal of the adversary proceeding will require his personal appearance before this Court and, if it is found that they are without merit, he will be responsible for the attorney's fees and costs of the Trustee in having to respond to them.

Based on the foregoing, it is hereby

ORDERED that Defendant's motion seeking to amend his Answer is denied; it is further

ORDERED that Defendant's motion seeking dismissal of the Trustee's Complaint is denied; and it is further

ORDERED that the Trustee's cross-motion seeking to enjoin the Defendant from filing any further motions in this adversary proceeding without leave of Court is denied, except as set forth herein.

Dated at Utica, New York

this 28th day of April 2003

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STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge